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California Debt and Investment Advisory Commission  
**RE-WRITING THE RULEBOOK: REGULATORY  
CHANGE AND THE MUNICIPAL MARKET**

***Secondary Affect: Changes That Impact  
Issuers' Balance Sheet and Investments***

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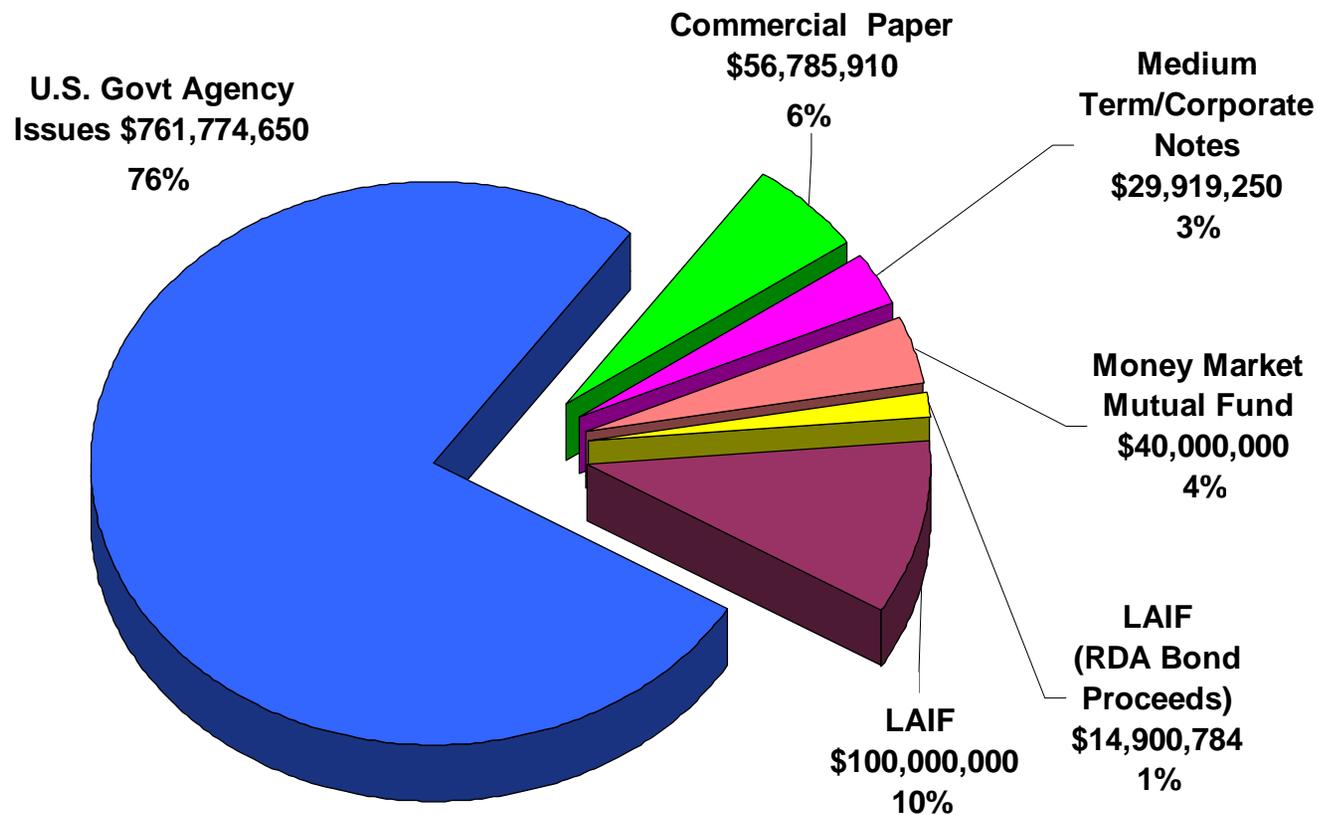
# Market Challenges as Investor and Issuer

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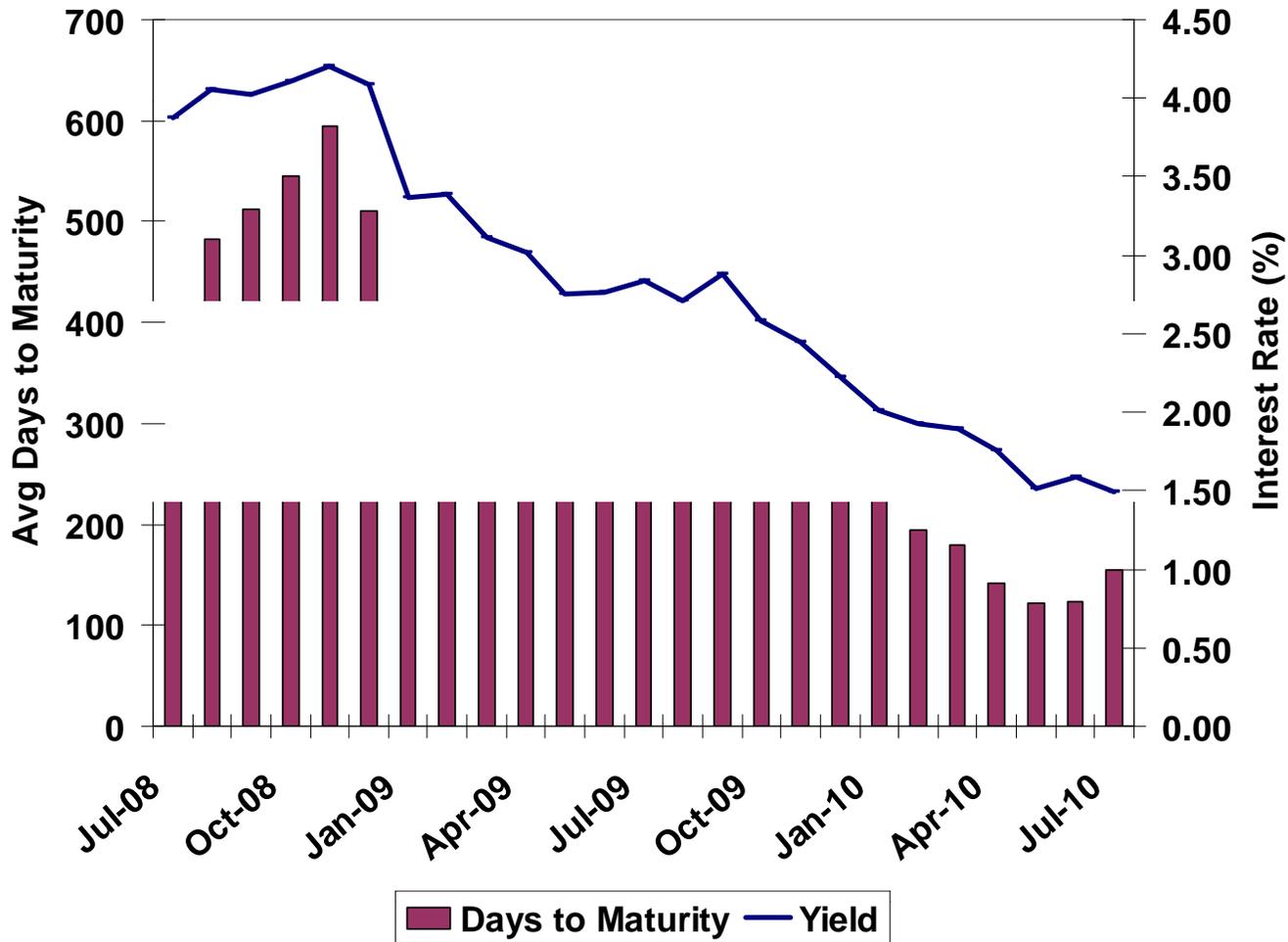
- As an Investor
  - Credit Exposure (Safety)
  - Increased Liquidity Needs (Liquidity)
  - Diminished Yields
  
- As an Issuer
  - Underlying Credit is **THE** credit
  - Credit Support / Liquidity Market
  - Market pressure for more disclosure/information coupled with political reality of declining resources

# San Jose "Snapshot" Investment Portfolio Composition

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# San Jose “Snapshot” Investment Portfolio Yield Comparison



# Investment Practice Changes

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- Credit Exposure
  - Highly rated credit today maybe be gone tomorrow
  - Government Agencies
  - Industry sectors
- Liquidity – declining days to maturity
  - Budgetary pressures
  - Revenue declines
- Expansion of Credit Analysis
  - Corporate Notes
  - Municipal Bonds

# “Status Quo” – Not an Investment Strategy

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- Investment Advisor
  - Not for Portfolio Management
  - Extension of Staff for Credit Analysis
  
- Enhanced Credit Analysis
  - Procedures for reviewing credit risk
  - Diversification of Portfolio in search of
    - Risk mitigation
    - Increased portfolio performance (i.e. Yield)

# Detailed Review and Modifications to Investment Policy

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- **No Deviation** from primary Investment Policy objectives of safety, liquidity & yield
- **No Deviation** from California Government Code, San Jose City Charter and Municipal Code
- **General Purpose of Policy Changes:**
  - clarify technical terms
  - strengthen consistency
  - increase portfolio diversification
  - reduce portfolio concentration risk, and
  - enhance the credit quality of the portfolio

# Key Changes to Investment Policy

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- Language to clarify Authorized Investments
  - Expanded the “A” rating to “A3, A-, or A- ”
  - Added language to ensure that no rating may be lower than any of the ratings listed above
- Modify language to conform to current financial market conditions
  - Money Market Mutual Funds’ adherence to the Securities and Exchange Commission (SEC) rule 2a-7
- Modify language to reflect changes to updated Investment Procedures

# Key Changes to Investment Policy

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- Add new asset classes or modify language to increase portfolio diversification potential
  - Mortgage & Asset Backed securities added
  - Time Deposits – removed limitation to banks located in San Jose area
- Modifications to percent limitations to decrease concentration risk and improve overall portfolio credit profile
  - Aggregate limitation on single institution to 10% of portfolio
  - Restrictions on concentration of investments in certain asset classes (Bankers Acceptances, Negotiable Certificates of Deposit, Commercial Paper, and Medium Term Notes)

# Summary of Percent Limitation Changes

| INVESTMENT TYPE                    | PRIOR CITY POLICY LIMITS | NEW CITY POLICY LIMITS | CA GOV'T CODE LIMITS |
|------------------------------------|--------------------------|------------------------|----------------------|
| Bankers Acceptances                | 25%                      | 20%                    | 40%                  |
| Negotiable Certificates of Deposit | 25%                      | 20%                    | 30%                  |
| Repurchase Agreements              | None                     | 50%                    | None                 |
| Corporate Notes                    | 15%                      | 20%                    | 30%                  |
| Money Market Mutual Funds          | 15%                      | 20%                    | 20%                  |
| Mortgage Backed Securities         | NA                       | 10%                    | 20%<br>MBS + ABS     |
| Asset Backed Securities            | NA                       | 5%                     | 20%<br>MBS + ABS     |

# Challenges as Issuer

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- Increased focus on “underlying” credit
  - Credit factors matter
  - Disappearance of homogenized municipal market
- Securing and negotiating liquidity facilities
  - Key component of diversified portfolios
  - Increased time and expertise of staff
- Market pressure for “more” disclosure
  - Lack of appreciation of quantity and quality of information available
  - Public operates in “Glass House”

# Summary

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- Continuous review of Investment Policy
- Credit Matters
  - Investment Portfolio
  - Debt Portfolio
- Not getting “easier”
  - Analytical capacity of staff key
  - Scrutinize and engage with consultants – don’t delegate your responsibilities